In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 872

J. FLEET COWDEN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

This federal income tax case presents three issues: (1) whether a transaction qualifies as a tax-free transfer of like-kind property under 1954 Code §1031, (2) whether certain payments by petitioner were ordinary and necessary business expenses, and (3) whether petitioner is liable for a penalty for late filing of his tax return. The Tax Court held for the Commissioner on all three issues (R. 81-92),[1] and the court of appeals affirmed *per curiam* (Pet. 14).

[1] "R" references are to the printed appendix filed by the petitioner in the court of appeals.

1. In 1953 petitioner [2] declared himself trustee of a parcel of vacant real estate, which was later subdivided into eleven lots. Petitioner, as trustee, hoped to induce a builder to construct a building on the corner lot by transferring to the builder as compensation the other ten lots. Although petitioner eventually entered into such an agreement with a contractor, the contractor thereafter refused to construct the building, but nevertheless claimed an interest in the ten lots. In order to settle this dispute petitioner, as trustee, sold the ten lots to the builder for $31,000 in 1959. Petitioner then constructed the building on the remaining lot, utilizing the $31,000 cash proceeds of the sale plus additional funds. (R. 82-84.)

The Code makes the settlor of a trust taxable on the trust's income if he has retained certain specified powers over the trust. 1954 Code §§ 671-677. Petitioner has stipulated that he retained the requisite powers and that he is taxable on the income of the trust here in question (R. 21, 86-87; Pet. 3-4).

Both lower courts correctly held that the trust (and thus petitioner) recognized a long term capital gain of $26,246 from its sale of the ten lots for $31,000 cash. The general rule is that a taxpayer realizes gain or loss upon any sale, exchange, or other disposition of an asset, measured by the difference between his cost basis for the asset and the value of the property received for it. 1954 Code §§ 1001, 1002. Section 1031 of the Code provides a very limited exception

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[2] Mrs. Cowden is a party only because she and her husband filed a joint return for 1959; her husband will be referred to as petitioner.

to this general rule where a taxpayer *exchanges* productive business property or tangible investment property for other property of a like-kind. It is clear that this relief provision applies only to transfers of these types of property in exchange for other such property; it does not apply to sales of such property for cash even though the cash is immediately reinvested in property of a like-kind. See *Coastal Terminals, Inc.* v. *United States*, 320 F. 2d 333, 337 (C.A. 4); *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, 36 (C.A. 6); *Bloomington Coca-Cola Bottling Co.* v. *Commissioner*, 189 F. 2d 14, 16 (C.A. 7); *Jordan Marsh Co.* v. *Commissioner*, 269 F. 2d 453, 455 (C.A. 2); 65 Cong. Record, Part 3, pp. 2798-2799; cf. *Knop* v. *United States*, 234 F. 2d 760 (C.A. 8). See also 1954 Code §§ 1033 and 1034, where Congress granted slightly broader relief in the case of sales of residences and condemnations of various kinds of property, allowing non-recognition of gain where the taxpayer disposes of such property for cash and, within a statutorily prescribed time, reinvests the proceeds in similar property.

The cases cited by petitioner (Pet. 8) held that where two taxpayers entered into mutually dependant and in part offsetting "sales" to each other of § 1031 property, the transactions were in substance exchanges rather than independent sales.[3] Here, however, petitioner sold the ten lots to one person for

[3] One of the cases cited on page 8 of the petition, *Thurber* v. *Commissioner*, 84 F. 2d 815 (C.A. 1), does not deal with § 1031 at all, but rather with whether the transaction there in question constituted a tax-free corporate reorganization.

$31,000 cash and then used the cash to pay others for goods and services. Such a transaction does not qualify as an "exchange" of property under § 1031.[4]

2. Before the sale of these lots, the trust had successfully brought a suit to quiet its title to the eleven lots. In 1959, petitioner (who was also an attorney), acting in his capacity as attorney for the trust, expended $3,226 in connection with this suit, for which he expected to be reimbursed by the trust when it began to produce income. Petitioner claimed a deduction for this amount as "disbursed to and for clients." (R. 84-85.)

Both lower courts correctly denied this deduction. The courts have consistently ruled that where an attorney incurs expenses on behalf of clients for which he expects to be reimbursed, these are advances in the nature of loans and thus not deductible as ordinary and necessary business expenses. *Hearn* v. *Commissioner*, 309 F. 2d 431 (C.A. 9), certiorari denied, 373 U.S. 909; *Burnett* v. *Commissioner*, 356 F. 2d 755 (C.A. 5), certiorari denied, 385 U.S. 832; *Cochrane* v. *Commissioner*, 23 B.T.A. 202, 207-208; see *Albright* v. *Commissioner*, 16 B.T.A. 1228. Thus the $3,226 here in question was an advance by petitioner to the trust. If the money had been expended for an ordinary and necessary business expense of the trust,

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[4] Moreover, even if petitioner had transferred the ten lots directly to a builder in exchange for the latter's services in erecting a building on the lot retained by petitioner, the transaction might not have qualified for § 1031 treatment if petitioner were, in essence, paying the builder compensation for services rendered. See *Bloomington Coca-Cola Bottling Co.* v. *Commissioner*, *supra*.

the trust would have been entitled to a deduction, and petitioner—as settlor of the trust—would have received that deduction (see *supra*, p. 2). However, the money was spent in perfecting or defending the trust's title to the real estate, and was thus a capital item. See, *e.g.*, Treas. Reg. § 1.263(a)-2(c).[5]

3. Petitioner did not file his 1959 income tax return until April, 1961—one year late. He claimed at trial that his failure to file the return on time was "due to reasonable cause and not due to willful neglect," and thus that he was not liable for the late filing penalty imposed by § 6651(a). The Tax Court found that in the circumstances of this case petitioner's failure to timely file the return "was not due to reasonable cause" (R. 86). Petitioner's two-fold defense was that he reasonably believed he owed no tax for 1959 and that, at the time the 1959 return was due, he was busy constructing the building discussed, *supra*, p. 2. (R. 85-86.)

Neither of these excuses constitutes "reasonable cause." The Code clearly requires any taxpayer with more than $600 of gross income to file a return

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[5] The Commissioner did not disallow an additional deduction of $1,091 claimed by petitioner for amounts "disbursed to and for clients" (R. 84-85). Even assuming, as petitioner alleges (Pet. 6), that the disallowed expenses were similar to those which were not disallowed, the Commissioner would not be estopped from denying the deductibility of the $3,276 here in question because he had failed to disallow an additional deduction. This is especially true here since, as the Tax Court observed (R. 90), the evidence failed to disclose the character of the $1,091 in expenses which were allowed as deductions.

(§ 6012(a)(1)) and imposes the late filing penalty —measured by the amount of tax due—on anyone who was required to file but failed to do so without "reasonable cause" (§ 6651(a)). Petitioner testified that he knew he had more than $600 of gross income, but failed to file because he believed—on advice of counsel—that no tax was due. As the lower court held, "we think it clear that Congress did not intend that a taxpayer's belief that no tax was due should constitute reasonable cause for failure to timely file a return" (R. 91). Nor did petitioner's preoccupation with his building project excuse him from filing his tax return on time.

The decision below is correct; there is no conflict of decisions or other reason for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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